LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 7550 **NOTE PREPARED:** Jan 12, 2007
BILL NUMBER: HB 1661 **BILL AMENDED:**

SUBJECT: Trademarks, Service Marks, and Patents.

FIRST AUTHOR: Rep. Austin **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: **X** **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *Patent-Derived Income Exemption:* The bill exempts income from adjusted gross income taxation that is derived from a qualified patent issued to a taxpayer domiciled in Indiana. It requires that a qualified patent must have resulted from a development process conducted in Indiana. It provides that a taxpayer may not claim more than $5,000,000 in exemptions in a taxable year. It also provides that a taxpayer may not claim an exemption for income derived from a particular qualified patent for more than five years.

Trademarks: The bill establishes that a color mark, scent mark, flavor mark, sound mark, or three dimensional mark may be registered if the mark meets certain conditions. It provides that a person may file an application to register a trademark or service mark if the person has a bona fide intention to use the mark and certain requirements are met. It requires a court to award attorney's fees to a prevailing party in certain actions concerning marks. It also removes: (1) trade names from the trademark law; and (2) the requirement that the secretary of state may require an applicant to provide information on whether the trademark or service mark has been filed in the United States Patent and Trademark Office.

Effective Date: July 1, 2007; January 1, 2008.

Explanation of State Expenditures: *Patent-Derived Income Exemption:* The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income. The DOR's current level of resources should be sufficient to implement the new exemption.

Trademarks: This bill will cause an increase in administrative costs to the Secretary of State (SOS) in requiring the amendment of forms, the development of procedures, and the adoption of rules concerning the changes in the bill related to trademark registration applications and by allowing registration of color, scent, flavor, sound, or three dimensional trademarks. It is anticipated that these provisions of the bill may be implement through the use of existing staff and resources. Furthermore, these costs may be offset to the extent that more trademark applications filing fees are collected (see *Explanation of State Revenues* below).

Explanation of State Revenues: *Patent-Derived Income Exemption:* The bill would reduce state Adjusted Gross Income (AGI) Tax of individual and corporate taxpayers that derive income from certain patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009. The maximum exemption a taxpayer may claim in a taxable year is $5 M. The maximum exemption amount translates into a $170,000 reduction in tax liability for an individual taxpayer, and a $425,000 reduction in tax liability for a corporate taxpayer. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from $1.7 M (if all the taxpayers are individuals) to $4.25 M (if all the taxpayers are corporations).

Trademarks: This bill allows registration of color, scent, flavor, sound, or three dimensional trademarks. By increasing the types of marks that may be registered, it is estimated that there will be an increase in fee revenue from the $10 trademark application and renewal filing fees. The amount of this increase is indeterminable and will depend upon number of new marks registered. Revenue from these fees are deposited in the state General Fund.

The bill also provides that a person may file an application to register a trademark or service mark if the person has a bona fide intention to use the mark and if certain requirements are met. Under current statute, a person may only file an application to register if the person has actually used the mark in Indiana. This change may also increase the number of registration applications filed and therefore increase fee revenue.

Background on Patent-Derived Income Exemption: The bill establishes an exemption from the AGI Tax for certain income derived in the taxable year from “qualified patents” issued to "qualified taxpayers" after December 31, 2007. The exemption applies to the following:

(1)Income derived from making, using, or selling an invention protected by the qualified patent.

(2) Royalties received from an assignment or license of the qualified patent.

(3) Damage awards or settlement proceeds recovered for infringement of the qualified patent.

The aggregate amount of patent-related income a taxpayer may exempt in a taxable year is $5 M. A taxpayer may claim the exemption with respect to a particular patent for up to 5 years. A “qualified patent” is a utility patent or plant patent issued for an invention resulting from a development process conducted in Indiana. Income derived from design patents is not eligible for the exemption. A “qualified taxpayer” is a taxpayer domiciled in Indiana, but does not include an institution of higher learning or a holding company.

Since 1995, an average of about 1,500 patents of all types (utility, plant, design, and other patents) have been granted annually to persons or entities in Indiana. However, annual patent totals for Indiana persons or entities have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. The annual patent total is attributable primarily to utility patents, with utility patents granted averaging about 1,300 per year since 1995. The annual total for utility patents granted to Indiana persons or entities also has declined from a high of 1,439 in 1999 to 1,108 in 2005. Data is unavailable as to annual total plant patents granted to Indiana persons or entities, however, it appears it does not exceed 100-200 per year based on the above-described averages. In addition, data is unavailable describing the typical income generated by patents granted to persons or entities in Indiana.

Since the exemption is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Revenue from the corporate AGI Tax is deposited in the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Definitions:

(1) A *design patent* may be granted to anyone who invents a new, original, and ornamental design for an article of manufacture.

(2) A *plant patent* may be granted to anyone who invents or discovers and asexually reproduces any distinct and new variety of plant.

(3) A *utility patent* may be granted to anyone who invents or discovers any new, useful, and nonobvious process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Patent-Derived Income Exemption:* Because the exemption for individuals receiving patent-derived income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue. Secretary of State.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: U.S. Patent and Trademark Office, Electronic Information Products Division, http://www.uspto.gov/web/offices/cio/cis/prodsvc.htm.

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